



AUDITOR - GENERAL
SOUTH AFRICA

The Accounting Officer
Mkhondo Local Municipality
PO Box 23
Piet Retief
2380

30 November 2016

Reference: 02394REG15/16

Dear Sir

Report of the Auditor-General on the financial statements and other legal and regulatory requirements of Mkhondo Local Municipality for the year ended 30 June 2016

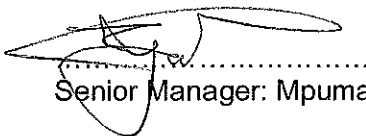
1. The above-mentioned report of the Auditor-General is submitted herewith in terms of section 21(1) of the Public Audit Act of South Africa read in conjunction with section 188 of the Constitution of the Republic of South Africa and section 121(3) of the Municipal Finance Management Act of South Africa (MFMA)
2. We have not yet received the other information that will be included in the annual report with the audited financial statements and have thus not been able to establish whether there are any inconsistencies between this information and the audited financial statements and the reported performance against pre-determined objectives. You are requested to supply this information as soon as possible. Once this information is received it will be read and should any inconsistencies be identified these will be communicated to you and you will be requested to make the necessary corrections. Should the corrections not be made we will amend and reissue the audit report.
3. In terms of section 121(3) (municipality) of the MFMA you are required to include the audit report in the [type of entity]'s annual report to be tabled.
4. Until the annual report is tabled as required by section 127(2) of the MFMA the audit report is not a public document and should therefore be treated as confidential.

5. Prior to printing or copying the annual report which will include the audit report you are required to do the following:
 - Submit the final printer's proof of the annual report to the relevant senior manager of the Auditor-General of South Africa for verification of the audit-related references in the audit report and for confirmation that the financial statements and other information are those documents that have been read and audited. Special care should be taken with the page references in your report, since an incorrect reference could have audit implications.
 - The signature *Auditor-General* in the handwriting of the auditor authorised to sign the audit report at the end of the hard copy of the audit report should be scanned in when preparing to print the report. This signature, as well as the place and date of signing and the Auditor-General of South Africa's logo, should appear at the end of the report, as in the hard copy that is provided to you. The official logo will be made available to you in electronic format.
6. Please notify the undersigned Business Executive / Senior Manager well in advance of the date on which the annual report containing this audit report will be tabled.
7. Your cooperation to ensure that all these requirements are met would be much appreciated.

Kindly acknowledge receipt of this letter.

Yours sincerely

Signed



Senior Manager: Mpumalanga Business Unit

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Auditor's report

Mkhondo Local Municipality

30 June 2016

Report of the auditor-general to the Mpumalanga Provincial Legislature and the council on the Mkhondo Local Municipality

Report on the financial statements

Introduction

1. I have audited the financial statements of the Mkhondo Local Municipality set out on pages ... to ..., which comprise the statement of financial position as at 30 June 2016, the statement of financial performance, statement of changes in net assets, cash flow statement and statement of comparison of budget and actual amounts for the year then ended, as well as the notes, comprising a summary of significant accounting policies and other explanatory information.

Accounting officer's responsibility for the financial statements

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with the South African Standards of Generally Recognised Accounting Practice (SA Standards of GRAP) and the requirements of the Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act of South Africa, 2015 (Act No. 1 of 2015) (DoRA), and for such internal control as the accounting officer determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor-general's responsibility

3. My responsibility is to express an opinion on these financial statements based on my audit. I conducted my audit in accordance with the International Standards on Auditing. Those standards require that I comply with ethical requirements, and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.
4. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the municipality's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the municipality's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.
5. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my qualified audit opinion.

Basis for qualified opinion

Property, plant and equipment

6. In terms of GRAP 17, *Property, plant and equity*, the municipality should account for all the assets that they have control over at the end of the financial year. Contrary to this, the municipality did not maintain proper systems to record and account for assets. Assets to the value of R709 771 661 were duplicated, incorrect bar codes were used and some assets did not have proper descriptions. Some assets had also been misallocated between the different classes of assets. As a result, I could not confirm the existence of some assets recorded in the fixed asset register by any alternative means. Consequently, I was unable to determine whether property, plant and equipment of R1 372 635 401 (2014-15: R1 235 147 701) disclosed in note 10 to the financial statements and the depreciation expense of R71 743 966 (2014-15: R71 324 854) disclosed in note 29 to the financial statements were fairly stated.

Irregular expenditure

7. I was unable to obtain sufficient appropriate evidence to satisfy myself as to the completeness of irregular expenditure, as adequate internal controls had not been established to identify irregular expenditure. In the prior year, irregular expenditure of R65 274 637 was identified during the audit process; however, the municipality failed to revise the whole population in this regard. I was unable to confirm the completeness of irregular expenditure by alternative means. Consequently, I was unable to determine whether any further adjustments were necessary to the irregular expenditure of R140 133 665 (2014-15: R134 395 703) disclosed in note 48 to the financial statements.

Qualified opinion

8. In my opinion, except for the effects of the matters described in the basis for qualified opinion paragraphs, the financial statements present fairly, in all material respects, the financial position of the Mkhondo Local Municipality as at 30 June 2016 and its financial performance and cash flows for the year then ended, in accordance with the SA Standards of GRAP and the requirements of the MFMA and DoRA.

Emphasis of matters

9. I draw attention to the matters below. My opinion is not modified in respect of these matters.

Restatement of corresponding figures

10. As disclosed in note 43 to the financial statements, the corresponding figures for 30 June 2015 have been restated as a result of an error discovered during the year ended 30 June 2016 in the financial statements of the municipality at, and for the year ended, 30 June 2015.

Material losses

11. As disclosed in note 49 to the financial statements, material losses of R30 130 496 (2014-15: R29 213 404) were incurred as a result of electricity distribution losses, which represented 31% (2014-15: 36%) of the total electricity purchased. Material losses of R759 363 (2014-15: R1 696 592) were also incurred as a result of water distribution losses, which represented 30% (2014-15: 83%) of the total water purchased.

Material impairments

12. As disclosed in note 3 to the financial statements, the receivables balance was significantly impaired. The impairment of consumer debtors amounted to R168 404 721 (2014-15: R139 138 993), which represented 86% (2014-15: 85%) of the total consumer debtors. The contribution to the provision for debt impairment was R29 265 728 (2014-15: R25 074 937).

Additional matters

13. I draw attention to the matters below. My opinion is not modified in respect of these matters.

Unaudited supplementary schedules

14. The supplementary information set out on pages ... to ... does not form part of the financial statements and is presented as additional information. I have not audited these schedules and, accordingly, I do not express an opinion thereon.

Unaudited disclosure notes

15. In terms of section 125(2)(e) of the MFMA, the municipality is required to disclose particulars of non-compliance with the MFMA. This disclosure requirement did not form part of the audit of the financial statements and, accordingly, I do not express an opinion thereon.

Report on other legal and regulatory requirements

16. In accordance with the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA) and the general notice issued in terms thereof, I have a responsibility to report findings on the reported performance information against predetermined objectives for selected development priorities presented in the annual performance report, compliance with legislation and internal control. I performed tests to identify reportable findings as described under each subheading but not to gather evidence to express assurance on these matters. Accordingly, I do not express an opinion or conclusion on these matters.

Predetermined objectives

17. I performed procedures to obtain evidence about the usefulness and reliability of the reported performance information for the following selected development priorities presented in the annual performance report of the municipality for the year ended 30 June 2016:
 - Development priority 1: basic service delivery on pages ... to ...
 - Development priority 4: financial viability and management on pages ... to ...
18. I evaluated the usefulness of the reported performance information to determine whether it was consistent with the planned development priorities. I further performed tests to determine whether indicators and targets were well defined, verifiable, specific, measurable, time bound and relevant, as required by the National Treasury's Framework for Managing Programme Performance Information (FMPPI).
19. I assessed the reliability of the reported performance information to determine whether it was valid, accurate and complete.
20. The material findings in respect of the selected development priorities are as follows:

Basic service delivery

Usefulness of reported performance information

21. Section 41(c) of the Municipal Systems Act of South Africa, 2000 (Act No. 32 of 2000) (MSA) requires the integrated development plan and service delivery agreement to form the basis for the annual report, therefore requiring consistency of objectives, indicators and targets between planning and reporting documents. Important reported objectives, indicators and targets were not consistent with those in the approved integrated development plan and service delivery agreement.
22. Section 25(2) of the MSA determines that an integrated development plan adopted by a municipal council may be amended in accordance with the process as prescribed per section 34 of the MSA, and that such a plan remains in force until an integrated development plan is adopted by the next elected council. Material changes were made to important objectives, indicators and targets in the annual performance report, without following the process as prescribed in section 34 of the MSA and without adoption by the municipal council.
23. The FMPPI requires performance targets to be specific in clearly identifying the nature and required level of performance and to be measurable. Important targets were not specific and measurable.
24. The processes and systems that produced the indicator should be verifiable, as required by the FMPPI. A total of 51% of the indicators were not verifiable.

Reliability of reported performance information

25. The FMPPI requires auditees to have appropriate systems to collect, collate, verify and store performance information to ensure reliable reporting of actual achievements against planned objectives, indicators and targets. I was unable to obtain the information and explanations I considered necessary to satisfy myself as to the reliability of the reported performance information. This was due to limitations placed on the scope of my work due to the absence of information systems, the fact that the municipality could not provide sufficient appropriate evidence in support of the reported performance information, and the municipality's records not permitting the application of alternative audit procedures.

Financial viability and management

Usefulness of reported performance information

26. Section 41(c) of the MSA requires the integrated development plan and service delivery agreement to form the basis for the annual report, therefore requiring consistency of objectives, indicators and targets between planning and reporting documents. Important reported objectives, indicators and targets were not consistent with those in the approved integrated development plan and service delivery agreement.
27. Section 25(2) of the MSA determines that an integrated development plan adopted by a municipal council may be amended in accordance with the process as prescribed per section 34 of the MSA, and that such a plan remains in force until an integrated development plan is adopted by the next elected council. Material changes were made to important objectives, indicators and targets in the annual performance report, without following the process as prescribed in section 34 of the MSA and without adoption by the municipal council.
28. The FMPPI requires performance targets to be specific in clearly identifying the nature and required level of performance and to be measurable. Important targets were not specific and measurable.
29. The FMPPI requires performance indicators to be well defined by having clear definitions so that data can be collected consistently and is easy to understand and use. A total of 25% of the indicators were not well defined.
30. The processes and systems that produced the indicator should be verifiable, as required by the FMPPI. A total of 58% of the indicators were not verifiable.

Reliability of reported performance information

31. The FMPPI requires auditees to have appropriate systems to collect, collate, verify and store performance information to ensure reliable reporting of actual achievements against planned objectives, indicators and targets. I was unable to obtain the information and explanations I considered necessary to satisfy myself as to the reliability of the reported performance information. This was due to limitations placed on the scope of my work due to the absence of information systems, the fact that the municipality could not provide sufficient appropriate evidence in support of the reported performance information, and the municipality's records not permitting the application of alternative audit procedures.

Additional matter

32. I draw attention to the following matter:

Achievement of planned targets

33. Refer to the annual performance report on pages ... to ... and ... to ... for information on the achievement of the planned targets for the year. This information should be considered in the context of the material findings on the usefulness and reliability of the reported performance information in paragraphs 21 to 31 of this report.

Compliance with legislation

34. I performed procedures to obtain evidence that the municipality had complied with applicable legislation regarding financial matters, financial management and other related matters. My material findings on compliance with specific matters in key legislation, as set out in the general notice issued in terms of the PAA, are as follows:

Strategic planning and performance management

35. The service delivery and budget implementation plan, used for implementing the municipality's delivery of municipal services and annual budget, did not indicate projections for each month of the revenue to be collected (by source) and the operational and capital expenditure (by vote), as required by sections 1 and 53(1)(c) of the MFMA.

Annual financial statements, performance report and annual report

36. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of the MFMA. Material misstatements of disclosure items identified by the auditors in the submitted financial statements were subsequently corrected and the supporting records provided, but the uncorrected material misstatements of assets resulted in the financial statements receiving a qualified audit opinion.

37. The annual performance report for the year under review did not include the performance of the municipality and of each service provider, a comparison with the previous financial year as well as measures taken to improve performance, as required by section 46(1)(b) and (c) of the MSA.

Procurement and contract management

38. Construction contracts were awarded to contractors that did not qualify for the contract, in contravention of section 18(1) of the Construction Industry Development Board (CIDB) Act of South Africa, 2000 (Act No. 38 of 2000) and CIDB regulations 17 and 25(7A).

Expenditure management

- 39. Money owed by the municipality was not always paid within 30 days, as required by section 65(2)(e) of the MFMA.
- 40. Reasonable steps were not taken to prevent unauthorised expenditure, as required by section 62(1)(d) of the MFMA.
- 41. Reasonable steps were not taken to prevent irregular expenditure, as required by section 62(1)(d) of the MFMA.
- 42. Reasonable steps were not taken to prevent fruitless and wasteful expenditure, as required by section 62(1)(d) of the MFMA.

Revenue management

- 43. A credit control and debt collection policy was not implemented, as required by section 96(b) of the MSA and section 62(1)(f)(iii) of the MFMA.

Asset management

- 44. An adequate management and accounting system was not in place to account for assets, as required by section 63(2)(a) of the MFMA.
- 45. An effective system of internal control for assets (including an asset register) was not in place, as required by section 63(2)(c) of the MFMA.

Internal control

- 46. I considered internal control relevant to my audit of the financial statements, annual performance report and compliance with legislation. The matters reported below are limited to the significant internal control deficiencies that resulted in the basis for the qualified opinion, the findings on the annual performance report and the findings on compliance with legislation included in this report.

Leadership

- 47. The accounting officer did not exercise oversight responsibility regarding financial and performance reporting and compliance as well as related internal controls.

Financial and performance management

- 48. Proper record keeping was not implemented in a timely manner to ensure that complete, relevant and accurate information was accessible and available to support financial and performance reporting, resulting in insufficient audit evidence for audit purposes.
- 49. Management did not ensure that controls were implemented over daily and monthly processing and reconciling of transactions.
- 50. Management did not prepare regular, accurate and complete financial and performance reports that were supported and evidenced by reliable information.
- 51. Management did not review and monitor compliance with applicable laws and regulations.

Governance

52. The internal audit unit and audit committee operated effectively during the current period as per their legislated mandate. Recommendations were made to management to improve internal controls and ensure reliable reporting of financial and performance information as well as compliance with legislation. However, this did not result in improved controls due to management not implementing the recommendations.

Auditor - General

Mbombela

30 November 2016



AUDITOR - GENERAL
SOUTH AFRICA

Auditing to build public confidence

